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January 8, 2010

VIA ELECTRONIC FILING

Mr. Charles L.A. Terreni
Chief Clerk/Administrator
South Carolina Public Service Commission
101 Executive Center Drive
Columbia, South Carolina 29210

Re: Application of Duke Energy Carolinas, LLC for Authority to Adjust and Increase Its Electric Rates and Charges
Docket No. 2009-226-E

Dear Mr. Terreni:

The attached Proposed Order is submitted on behalf of all parties to the settlement agreement filed with the Commission in this matter on November 24, 2009. This includes the South Carolina Office of Regulatory Staff, Duke Energy Carolinas, The South Carolina Energy Users Committee, and the environmental groups which have been referred to in prior pleadings and correspondence as the "Environmental Intervenors." Please note that the Environmental Intervenors join in submission of this Proposed Order only with respect to those portions related to Duke Energy Carolinas' modified save-a-watt proposal (findings and conclusions 22-25 and evidence in support thereof), and by joining in this submission take no position with regard to the remainder of the Proposed Order.

Please do not hesitate to contact me if you have any questions in regards to the attached Proposed Order.

Very truly yours,

Jeffrey M. Nelson

cc: Parties of Record

BEFORE

THE PUBLIC SERVICE COMMISSION OF

SOUTH CAROLINA

DOCKET NO. 2009-226-E

In re: Application of Duke Energy Carolinas, LLC For Authority to Adjust and Increase Its Electric Rates and Charges	)	**ORDER APPROVING SETTLEMENT AGREEMENT AND INCREASE IN RATES AND CHARGES**

This matter comes before the Public Service Commission of South Carolina ("Commission") on the Application of Duke Energy Carolinas, LLC ("Duke Energy Carolinas" or "Company") filed July 27, 2009, ("Application") requesting authority to adjust and increase its electric rates, charges, and tariffs, and to approve the proposed mechanism to compensate the Company for the energy efficiency programs approved in Docket No. 2009-166-E, Order No. 2009-336. The Application was filed pursuant to S.C. Code Ann. §§ 58-27-820 and 58-27-870 (Supp. 2009) and 26 S.C. Code Ann. Regs. 103-303 and 103-823 (Supp. 2009).

On July 27, 2009, the Company also filed the direct testimony and exhibits of Brett C. Carter, President of Duke Energy Carolinas; James L. Turner, Group Executive of Duke Energy Corporation ("Duke Energy"), the parent corporation of Duke Energy Carolinas, President and Chief Operating Officer of Duke Energy's U.S. Franchised Electric and Gas Business, and an officer and director of Duke Energy Carolinas; Dhiaa M. Jamil, Group Executive and Chief Generation Officer of Duke Energy and Chief Nuclear Officer of Duke Energy Carolinas; Stephen G. De May, Senior Vice President, Treasurer and Chief Risk Officer of Duke Energy; Steven M. Fetter, President of Regulation UnFettered; James H. Vander Weide, Research Professor of Finance and Economics at Duke University's Fuqua School of Business and

President of Financial Strategy Associates; J. Danny Wiles, Vice President of Franchised Electric and Gas Accounting for Duke Energy; John J. Spanos, Vice President of the Valuation and Rate Division of Gannett Fleming, Inc.; Phillip O. Stillman, General Manager of Regulatory Accounting and Planning for Duke Energy Business Services, LLC; Jane L. McManeus, Director,Rates for Duke Energy Carolinas; Carol E. Shrum, Vice President, Rates for Duke Energy Carolinas; Jeffrey R. Bailey, Director, Pricing and Analysis for Duke Energy Carolinas; Raiford L. Smith, Director, Strategy and Collaboration for Duke Energy Business Services LLC, a service company affiliate of Duke Energy Carolinas; and Richard G. Stevie, Managing Director of Customer Market Analytics for Duke Energy Business Services, LLC., a wholly-owned service company subsidiary of Duke Energy. The Company filed supplemental direct testimony for Company witnesses Bailey, McManeus, Shrum, and Turner on September 25, 2009.

The Company's electric rates and charges, excluding riders and changes in the fuel cost component, were last approved by the Commission in Docket No. 91-216-E, *Order Approving Rate Increase, No. 91-1022*, dated November 18, 1991; and *Order Approving Rate Schedules, No. 91-1081*, dated December 4, 1991. In the Application, the Company requested that the Commission approve a return on common equity ("ROE") of 12.3%. As a rate mitigation measure, the Company proposed that the revenue requirement and resulting rates be calculated using a lower ROE of 11.5%.

On July 30, 2009, the Commission's Docketing Department instructed the Company to publish a Notice of Filing and Hearing in newspapers of general circulation in the areas affected by the Company's Application by August 14, 2009. The Notice of Filing and Hearing indicated the nature of the Company's Application and advised those desiring to participate in the

proceeding scheduled to begin November 30, 2009, of the manner and time in which to file appropriate pleadings. The Company was also required to notify directly all customers affected by the proposed rates and charges. On August 21, 2009 the Company filed affidavits with the Commission demonstrating that the Notice was duly published in accordance with the Docketing Department's instructions. Pursuant to Commission Directive, Order No. 2009-725, the Docketing Department scheduled public hearings in Greenville, Greenwood, and Spartanburg Counties and directed the Company to publish Notices of Public Hearings in newspapers of general circulation in the areas affected. On November 4, 2009, and November 13, 2009, the Company filed affidavits demonstrating that these Notices of Public Hearings were duly published in accordance with the Docketing Department's instructions. Duke Energy Carolinas also provided telephone notice of the public hearings to its customers using the Company's automated dialing system during the first two weeks of November.

The South Carolina Energy Users Committee ("SCEUC") represented by Scott Elliott, Esquire, filed a petition to intervene on August 6, 2009. Southern Alliance for Clean Energy, the Southern Environmental Law Center, the Natural Resources Defense Council, Environmental Defense Fund, and the South Carolina Coastal Conservation League (collectively referred to as the "Environmental Intervenors") represented by J. Blanding Holman, IV, Esquire and Gudrun Elise Thompson, Esquire, admitted *pro hac vice,* filed their petition to intervene on September 25, 2009. The South Carolina Green Party ("Green Party") represented by Rolf M. Baghdady, Esquire filed a petition to intervene on October 1, 2009. The Office of Regulatory Staff ("ORS"), automatically a party pursuant to S.C. Code Ann. § 58-4-10(B)(Supp. 2009), was represented by Jeffrey M. Nelson, Esquire; Shannon Bowyer Hudson, Esquire; and Shealy Boland Reibold, Esquire. Duke Energy Carolinas was represented by Catherine E. Heigel,

Esquire, Lara Simmons Nichols, Esquire, admitted *pro hac vice*, Frank R. Ellerbe, III, Esquire; and Bonnie D. Shealy, Esquire. Collectively, SCEUC, the Environmental Intervenors, the Green Party, ORS and Duke Energy Carolinas are referred to as "the Parties" or individually as a "Party."

On November 2, 2009, ORS filed the direct testimony and exhibits of Douglas H. Carlisle, Jr., Ph.D., Economist; M. Anthony James, Associate Program Manager in the Electric Department; Sharon G. Scott, Senior Manager for Rate Cases; and A. Randy Watts, Program Manager in the Electric Department. SCEUC filed the direct testimony and exhibits of Kevin W. O'Donnell, President of Nova Energy Consultants, Inc. and on November 5, 2009 the Green Party filed the direct testimony of Gregg Jocoy, co-chair of the Green Party. On November 6, 2009, direct testimony and exhibits related to Duke Energy Carolina's modified save-a-watt program was filed by ORS Witness Kevin Cooney, Chief Executive Officer of Summit Blue Consulting, LLC, and the Environmental Intervenors' Witness John D. Wilson, Director of Research for the Southern Alliance for Clean Energy ("SACE"). On November 16, 2009, the Company filed the rebuttal testimony and exhibits of witnesses Bailey, De May, McManeus, Shrum, Smith, Stillman, Turner, and Vander Weide. Surrebuttal testimony was filed by ORS witnesses James and Scott on November 23, 2009.

On November 24, 2009, ORS, on behalf of all Parties except the Green Party ("Settling Parties"), filed an Explanatory Brief and Joint Motion for Approval of Partial Settlement[1] and Adoption of Settlement Agreement[2] ("Settlement"). The Settlement Agreement and Attachments

[1] The Parties to the Settlement Agreement have resolved all issues.
[2] The Environmental Intervenors joined the Settlement Agreement for the purpose of endorsing and supporting Duke Energy Carolinas' modified save-a-watt program. The Environmental Intervenors took no position in this proceeding with regard to the remaining terms of the Settlement Agreement.

A and B are attached as Order Exhibit 1 and incorporated by reference. Settlement Attachment A reflects the Company's operating experience, accounting adjustments and the increase in annual revenues from base rates of $74,125,000. Settlement Attachment B shows the allocation by customer class of the increase in revenues. Duke Energy Carolinas filed settlement testimony and exhibits of witnesses Turner, Shrum, Bailey, McManeus, Smith, and Stevie. SCEUC filed the settlement testimony and exhibits of Edward G. Cochrane, Vice President and Corporate Secretary of Mount Vernon Mills and Chairman of the SCEUC.

Public hearings were held on November 19, 2009, in Greenwood; November 23, 2009, in Greenville; and November 24, 2009, in Spartanburg. Duke Energy Carolinas filed a response to certain testimony provided by members of the public during the night hearings on December 9, 2009.

The Commission conducted an evidentiary hearing on this matter from November 30, 2009 through December 2, 2009 in the hearing room of the Commission with the Honorable Elizabeth B. Fleming presiding. At the outset of the hearing, counsel for the Settling Parties described the partial settlement. The Settlement was accepted into the record as composite Hearing Exhibit 1. The Settlement Agreement is attached as Order Exhibit No. 1 and incorporated by reference.

Public Witness John Wiebel appeared and testified. Duke Energy Carolinas witnesses Turner, Carter, Jamil, DeMay, Fetter, Vander Weide, Wiles, Spanos, Stillman, Shrum, Bailey, McManeus, Smith and Stevie; ORS witnesses Carlisle, James, Scott and Cooney; SCEUC witnesses O'Donnell and Cochrane; Environmental Intervenors' witness Wilson; and Green Party witness Jocoy also appeared, gave summaries of their testimonies and answered questions from the Commission.

Duke Energy Carolinas witness Turner provided an overview of the reasons for the Company's request for a rate increase and an overview of the Settlement. Company witness Stephen G. De May addressed credit quality, the Company's capital structure and cost of debt, the Company's credit ratings, the forecast of the Company's capital needs and Duke Energy Carolinas' financial objectives. Dhiaa M. Jamil described the Company's operations and capital additions since the last rate case, and discussed key drivers impacting operations and maintenance costs for nuclear and fossil-hydro operations.

The hearing reconvened on December 1, 2009, with Brett C. Carter testifying about Duke Energy Carolinas' operations, customer service and rate issues from a policy basis. Company witness Fetter discussed the perspective of investors with respect to credit ratings, regulatory environment, and ROE for Duke Energy Carolinas in the context of the current rate case. Dr. James Vander Weide presented his independent analysis of a fair ROE that would allow Duke Energy Carolinas to attract capital on reasonable terms. J. Danny Wiles discussed the financial position and results of Duke Energy Carolinas' operations for the test period ending December 31, 2008. Company witness Turner returned to the witness stand to answer questions raised by the Commission concerning a trade publication op-ed authored by Duke Energy Chief Executive Officer James E. Rogers. Company witnesses Stillman, McManeus, and Shrum testified as a panel on accounting issues and the base fuel factor.

SCEUC witness Cochrane testified in support of the Settlement and stated that the terms of the Agreement would provide a much needed reprieve to South Carolina industries which are struggling in the current economic recession. Company witness Spanos then presented his independent analysis of the depreciation study he conducted for Duke Energy Carolinas. Jeffrey R. Bailey discussed the Company's proposed rate design and charges. Company witness Bailey

also testified in support of the settlement in regard to customer rate impacts and rate design issues. SCEUC witness O'Donnell testified about the return on equity, capital structure and rate design.

ORS then presented its witnesses. Sharon Scott's testimony explained the findings and recommendations as reflected in the ORS Audit Exhibits resulting from ORS's examination of Duke Energy Carolinas' Application. ORS witness Dr. Douglas Carlisle testified regarding his study and analysis of markets, economic conditions, and the Company's capital structure and recommended a ROE for the Company. Anthony James provided a summary of his own testimony and additionally adopted the testimony of ORS witness Randy Watts. Mr. James summarized the ORS Electric Department's examination of the Company's Application.

The hearing on December 2, 2009, dealt with the Company's modified save-a-watt proposal. Company witness Raiford L. Smith described the modified save-a-watt incentive mechanism, the opt-out proposal and new energy efficiency programs. His settlement testimony addressed certain changes to the modified save-a-watt resulting from the Settlement. Jane L. McManeus's testimony supported the approval of a rider ("Rider EE") designed to collect sufficient revenues to cover the Company's energy efficiency and demand-side management program costs, lost revenues, and an incentive, including the program costs deferred pursuant to Order No. 2009-336 in Docket No. 2009-166-E. Richard G. Stevie, Ph.D. explained the DSMore© model used to evaluate the Company's energy efficiency and demand-side management programs. His settlement testimony explained the revised values for the PowerShare demand-side management program and the agreement concerning independent oversight of the modified save-a-watt mechanism by a third party consultant hired by ORS. The Environmental Intervenors' Witness John Wilson explained why the Environmental Intervenors

support the modified save-a-watt proposal. ORS Witness Cooney presented his review and analysis of the proposed save-a-watt mechanism.

As requested by the Commission, Duke Energy Carolinas filed five late-filed hearing exhibits on December 11, 2009 relating to salaries, reliability standards, EEI data by customer class, additional information on average rate impacts of the Settlement Agreement by customer class, and income tax information. The Parties filed proposed orders and legal briefs on January 8, 2010.

FINDINGS OF FACT AND CONCLUSIONS OF LAW

Based upon the Application, the Settlement Agreement, the testimony, and exhibits received into evidence at the hearing and the entire record of these proceedings, the Commission makes the following findings of fact and conclusions of law:

A. JURISDICTION

1. Duke Energy Carolinas is a limited liability company duly organized and existing under the laws of the State of North Carolina. It is a public utility under the laws of the State of South Carolina and is subject to the jurisdiction of this Commission pursuant to S.C. Code Ann. § 58-3-140(A)(Supp. 2009). The Company is engaged in the business of generating, transmitting, distributing, and selling electric power to the public in western South Carolina and a broad area of central and western North Carolina. Duke Energy Carolinas is a wholly-owned subsidiary of Duke Energy, both having their offices and principal places of business in Charlotte, North Carolina.

2. The Commission has jurisdiction over the rates and charges, rate schedules, classifications, and practices of public utilities operating in South Carolina, including Duke Energy Carolinas, as generally provided in S.C. Code Ann. §§ 58-27-10, *et seq.* (1976 & Supp. 2009).

3. Duke Energy Carolinas is lawfully before the Commission based upon its Application for a general increase in its retail rates pursuant to S.C. Code Ann. §§ 58-27-820 and 58-27-870, and 26 S.C. Code Ann. Regs. 103-303 and 103-823.

4. The appropriate test period for use in this proceeding is the 12 months ended December 31, 2008.

B. SETTLEMENT

5. Duke Energy Carolinas, by its Application and initial direct testimony and exhibits, originally sought an increase of $132.9 million in its annual electric sales revenues from its South Carolina retail electric operations. The Company requested an 11.5% ROE while supporting a 12.3% ROE. On September 25, 2009, the Company filed supplemental direct testimony and exhibits revising the base fuel factor to conform to the fuel rates approved by the Commission in Docket No. 2009-3-E, Order No.2009-695, and to present additional adjustments to its cost of service.

6. Duke Energy Carolinas submitted evidence in this case with respect to revenue, expenses and rate base using a test period consisting of the 12 months ended December 31, 2008. The Settlement is based upon the same test period.

7. On November 24, 2009, ORS, on behalf of the Settling Parties, filed an Explanatory Brief and Joint Motion for Approval of Partial Settlement and Adoption of

Settlement Agreement. The Settlement Agreement comprehensively resolved all issues in this proceeding among all of the Settling Parties.[3]

8. The Settlement Agreement adopts all accounting and pro forma adjustments appended to the Settlement Agreement as Attachment A. The Commission finds and concludes that the accounting recommendations agreed upon in the Settlement Agreement are just and reasonable to all parties in light of all the evidence presented.

9. The Commission, having carefully reviewed the Settlement Agreement and all of the evidence of record, finds and concludes that the provisions of the Settlement Agreement are just and reasonable to all parties, are in the public interest, and should be approved in their entirety. The specific terms of the Settlement Agreement are addressed in the following findings of fact and conclusions.

(a) Return on Equity

10. The Settlement Agreement provides for base rates to generate a revenue increase of $74,125,000 from the Company's South Carolina retail electric operations on a test year basis adjusted to reflect the accounting adjustments reflected in Attachment A of the Settlement Agreement. The Settlement Agreement also provides that rates to reflect this electric revenue increase would be calculated based on a 10.7% ROE. In recognition of the Company's base load plans and its current cost of equity, the Settlement Agreement provides that the Company should be allowed a ROE of 11%. The Commission has reviewed the Settlement Agreement's provisions for an annual electric sales revenue increase of $74,125,000, and finds and concludes

that this increase in the level of base rates to be paid by Duke Energy Carolinas' South Carolina retail customers calculated on a 10.7% ROE is just and reasonable. The Commission further finds and concludes that the evidence in the record of this proceeding supports the establishment of an ROE of 11% for Duke Energy Carolinas.

(b) Subsequent Rate Increase Requests

11. The Settlement Agreement provides that Duke Energy Carolinas shall not seek an increase in its non-fuel base rates and charges prior to June 2011, and that in any case no increase in non-fuel base rates shall or may be billed to its ratepayers until the Company's first billing cycle in 2012. The Commission finds and concludes that this provision of the Settlement Agreement is just and reasonable to all parties and is supported by substantial evidence in the record.

(c) Riders and Accounting Adjustments

12. **Return of DSM Balance.** Order No. 91-1022 in Docket No. 91-216-E approved a deferred accounting process for energy efficiency and demand-side management programs (collectively "DSM costs"). The Settlement Agreement provides that a rider will be established to flow back the over-collection of funds to the Company's South Carolina customers from the demand-side management deferral account balance ("DSM balance"). The DSM balance will be returned over a three-year period at approximately $43.5 million per year or until the DSM balance is exhausted. The refund shall be apportioned in accordance with the class of customers supplying revenues to Duke Energy Carolinas during the period of the DSM program. In

addition, as set forth in the direct testimony of Company witness McManeus, the initially estimated revenue requirements for programs implemented during the period of June 1, 2009 through the effective date of new rates and charges approved pursuant to this Order and all associated true-up amounts will be applied as an offset to the existing balance of DSM costs owed to customers rather than billed to customers under Rider EE. The Commission finds and concludes that the provisions of the Settlement Agreement and Ms. McManeus' direct testimony relating to the return of the DSM balance are just and reasonable to all parties and are supported by the evidence contained in the record in this docket.

13. **Nuclear Insurance Credit.** The Settlement Agreement provides that the revenue increase is subject to a decrement rider to flow to the Company's South Carolina retail customers $13,000,000 per year for a period of two years representing a portion of the monies previously accumulated in the Company's nuclear insurance reserve account from insurance dividends. The Commission finds and concludes that the decrement rider to achieve outcome at this time is just and reasonable to all parties and is supported by the facts in evidence in this matter.

14. **Storm Reserve Fund.** The Settlement Agreement provides that the Company may include a charge per kWh in base rates to establish a Storm Reserve Fund. The charge will be designed to collect approximately $5,000,000 per year based on test year sales. The amount in the Storm Reserve Fund shall not exceed a total of $50,000,000. The Commission finds and concludes that this provision of the Settlement Agreement is just and reasonable to all parties and is supported by the evidence in the record of this case.

15. **Fuel Stock Inventory.** The Settlement Agreement provides that the revenue increase is subject to an interim rider to defray the carrying costs of fuel-stock inventory over target. The rider will automatically expire when coal inventories reach a full-burn 40-day supply

on a sustained basis as defined in Section B(4) of the Settlement Agreement or on April 30, 2011, whichever occurs first. The amount collected will be based on estimated monthly coal inventory levels and will be trued-up to reflect actual monthly coal inventory levels. The Commission finds and concludes that the rider is just and reasonable to all parties and is supported by substantial evidence in the record.

16. **Pension Costs Rider.** The Settlement Agreement provides for the removal from operating expenses of $3,574,000 in pension costs and the establishment of a rider to collect the difference between the pension expense amount collected in base rates and the actual expense amount. The rider is adjusted annually and subject to a true-up. Duke Energy Carolinas shall provide a quarterly tracking report to ORS regarding Pension Fund obligation and the market value of the assets available to meet that obligation. The Pension Cost Rider will be evaluated during Duke Energy Carolinas' next general rate case or will expire no later than three (3) years from the date of this Order. The Commission finds and concludes that the rider is just and reasonable to all parties and is supported by substantial evidence in the record.

17. **Capacity Purchase.** The Settlement Agreement removes the South Carolina jurisdictional cost of $6,770,782 associated with the capacity purchase from Columbia Energy, LLC from base rates and amortizes it over a two-year period resulting in $3,385,391 being excluded from test year expenses. The Commission finds this adjustment to be reasonable and in the public interest.

18. **GridSouth Adjustment.** The Commission finds the Settlement Agreement's provision allowing Duke Energy Carolinas to recover its South Carolina retail cost of $9,436,497 over five years with $1,887,299 to be included in test year expenses as fair and reasonable and in keeping with the Commission's treatment of the GridSouth investments by South Carolina

Electric & Gas Company ("SCE&G"). The Commission finds the GridSouth investment was prudently incurred, prudently abandoned, and allows Duke Energy Carolinas to recover its investment over a five-year period excluding a return on the investment.

(d) Rate Increase Allocation & Design

19. The Settlement Agreement provides that the agreed-upon increase in annual revenues of $74,125,000, subject to the riders outlined above, will initially produce a net increase in annual revenues of $24,191,000 based on the test year. The average base rate change to the various customer classes is as follows: 9.3% for residential customers, 5.5% for general service customers, and -0.1% for industrial class customers. When the rate riders are included in the aforementioned changes, the rate increase to customers is as follows: 9.2% for residential customers, 3.9% for general service customers, and -4.9% for industrial customers. We find that the Settlement Agreement's proposed increase with the implementation of the riders is in the public interest, prudent and reasonable, and supported by substantial evidence in the record.

20. Settlement Agreement Attachment B sets forth the proposed rate increases and the respective rates of return by customer class. The Commission finds and concludes that these proposed increases represent an appropriate reduction to interclass rate subsidies. The Commission also finds that the proposed rates and allocation set forth in Settlement Agreement Attachment B are just and reasonable and supported by the evidence in the record.

21. The Settlement Agreement adopted the Company's proposed rate design modifications with the exception of the items listed below. The agreed upon modifications to Duke Energy Carolinas' rate design proposals include the following:

a. Rate MP will be closed and the availability will be modified to permit new plants or locations for customers already served under this rate to be eligible for service.

b. No changes will be made to distribution charges of Rate HP-X (Renamed Rate HP).
c. The Third Block of Rate I will not be modified at this time.
d. The incremental demand charge of Rate HP-X (renamed Rate HP in this case) will not be increased.

The Company additionally proposed to modify its Service Regulations to clarify and acknowledge current practices and proposed to add a provision to its Underground Distribution Installation Plan to provide an idle facilities provision. The Commission finds and concludes that the changes to proposed rates and Service Regulations proposed by the Company as modified by the Settlement Agreement and ORS witness Watts' testimony are just and reasonable and supported by substantial evidence in the record.

(e) Modified Save-a-watt Proposal

22. The Settlement Agreement provides for approval of a Rider EE designed to collect sufficient revenues to cover the Company's energy efficiency and demand-side management program costs, including the program costs deferred pursuant to Order No. 2009-336 in Docket No. 2009-166-E, lost revenues, and an incentive.

23. Section III, paragraphs (2) through (7), of the Settlement Agreement modified the following provisions of the save-a-watt proposal:

a. ORS will hire an independent third party consultant pursuant to S.C. Code Ann. §58-4-100 (Supp. 2009) to provide independent oversight of the [save-a-watt] mechanism, and Duke Energy Carolinas will provide certain information as outlined in the Settlement Agreement in Section III, paragraph (2).

b. All program costs, avoided costs and lost revenues associated with its interruptible service ("IS") and standby generation ("SG") programs ("Existing DSM Programs") are excluded from the [save-a-watt] program. Existing DSM Programs' cost will be a separate component of its proposed Rider EE. The Settlement Agreement also establishes the transition of South Carolina customers

to the Company's PowerShare program and its effect on the recovery of the avoided costs.

c. The avoided energy and capacity costs will remain fixed until the evaluation, measurement, and verification ("EM&V") true-ups occur. If combined avoided energy and capacity costs increase or decrease by more than 25%, the programs will be re-analyzed to determine whether the portfolio of programs should be modified.

d. A mid-term EM&V-based true-up process will occur with results to be reflected in Vintage Year 3 Rider EE collections. A final true-up will occur in year 6.

e. Qualified industrial customers may elect to opt out of the energy efficiency component of Rider EE on an annual basis and may opt out of the demand-side management component of Rider EE upon a one-time election, for the four year energy efficiency plan, made within sixty days of the date of the Commission's Order in this docket.

f. To the extent that industrial customers opt out of the energy efficiency plan, the forecasted retail sales and the anticipated participant rate in demand-side management and energy efficiency programs will be adjusted.

After careful review and consideration of the Settlement Agreement's provisions, the Commission concludes that approval of the modified save-a-watt proposal is in the public interest and that the revisions agreed to by the Settling Parties are reasonable and prudent.

24. The Settlement Agreement provides that revised Rider EE rates for Vintage 1 are

Residential	0.1736 ¢/kWh
Non-residential –Energy Efficiency	0.0195 ¢/kWh
Non-residential – Demand Side Management	0.0360 ¢/kWh

We find and conclude that the revised Rider EE rates for Vintage 1 are designed to recover the revenue requirement in an equitable and reasonable manner, and are just and reasonable to all parties and supported by substantial evidence contained in the record in this docket.

25. The modified save-watt approach, as an incentive mechanism, is consistent with the law and public policy of South Carolina, specifically, S.C. Code Ann. Section 58-37-20

(Supp. 2009). We find and conclude that the modified save-a-watt proposal is just and reasonable and promotes demand-side management and energy efficiency.

The evidence in support of the following findings of fact are found in the verified Application as amended, the Settlement Agreement, pleadings, testimony and exhibits in this docket, and the entire record in this proceeding.

Jurisdiction

EVIDENCE FOR FINDINGS AND CONCLUSIONS NOS. 1 THROUGH 4

Duke Energy Carolinas is an electric utility subject to the jurisdiction of the Commission pursuant to S.C. Code Ann. Sections 58-3-140(A) (Supp. 2009). South Carolina uses an historic twelve-month test period. 26 S.C. Code Ann. Regs. 103-823(A)(3). These findings and conclusions are informational, procedural and jurisdictional in nature and are not contested by any party.

Settlement

EVIDENCE FOR FINDINGS AND CONCLUSIONS NOS. 5 THROUGH 9

The Commission last approved the Company's electric rates and tariffs, excluding riders and changes in the fuel cost component in Order Nos. 91-1022 and 91-1081 in Docket No. 91-216-E. Order No. 91-1022 allowed Duke Energy Carolinas the opportunity to earn a rate of return of 12.25% on the common equity component of its South Carolina retail jurisdictional rate base. The test period in that case was the twelve months ended December 31, 1990.

On July 27, 2009, Duke Energy Carolinas filed its Application and initial direct testimony and exhibits, seeking an increase of $132.9 million or 9.3% average increase in its annual electric sales revenues from its South Carolina retail electric operations. After the Commission issued Order No. 2009-695, in Docket No. 2009-3-E, Company witness McManeus filed supplemental testimony supporting the revision to the base fuel factor to conform to the new fuel rates.

The Settlement Agreement filed by the Parties in this docket provides for an increase of $74,125,000 in Duke Energy Carolinas' annual revenues from kWh sales from its South Carolina retail electric operations. The agreed upon increase is subject to the riders outlined in the Settlement Agreement which adjust the requested increase in annual revenues to produce a net increase of $24,191,000. Duke Energy Carolinas submitted evidence in this case with respect to revenue, expenses and rate base using a test period consisting of the 12 months ended December 31, 2008. The Settlement Agreement is based upon the same test period.

Need for Rate Increase

Company witnesses Turner and Carter provided testimony as to the Company's need for a rate increase. According to Mr. Carter, the Company's financial position will suffer if it continues to serve its customers at current prices. He stated that the Company needs to maintain sufficient cash flow and credit quality to finance necessary capital expenditures on reasonable terms, especially during this period of economic volatility. *(Tr. Vol. 5, p.574).*

Company witness Turner further testified that capital investments in production, transmission and distribution assets have increased significantly since the Company's rates were last adjusted, and that current rates are not producing sufficient revenues to allow the Company

to meet its day to day expenses and also provide a reasonable return for Duke Energy Carolinas' investors. *(Tr. Vol. 4, p.327).* Since the 1991 general rate case, Duke Energy Carolinas has invested approximately $12 billion in gross electric plant in service and projects an additional $2 billion by September 30, 2009, when coupled with Construction Work in Progress ("CWIP"). Since 2006, the Company has incurred the following system-wide expenses: transmission and distribution investments totaling approximately $1 billion; over $700 million in investments in the Company's existing generation fleet related to upgrades, refurbishment, reliability, environmental and other regulatory compliance and relicensing; additional near-term expected rate base additions of approximately $1 billion; and CWIP investments at Cliffside Unit 6 of approximately $700 million as of year-end 2008 which is expected to grow to approximately $1 billion by the end of September 2009. *(Tr. Vol. 4, p.327-328).*

Witness Turner explained that with these investments and on-going operating expenses, Duke Energy Carolinas' rates are producing an overall rate of return of 6.92%, and a 7.89% ROE invested in the Company – well below the returns authorized by the Commission in the Company's last rate case and below the Company's cost of capital and what is necessary to continue to attract needed capital. *(Tr. Vol.4, p. 328).* Mr. Turner testified that this will be Duke Energy Carolinas' first general rate increase since 1991 and that even with the requested rate increase the Company's average South Carolina retail electric rates will be lower than they were in 1991 on an inflation-adjusted basis. *(Tr. Vol. 4, p. 328-329).*

Witness Turner described how the Company is facing the need to upgrade and modernize significant portions of its generation, transmission and distribution systems, as well as incorporate new technology into its power systems, while continuing to meet Duke Energy Carolinas customers' demand for electricity in a reliable manner. *(Tr. Vol. 4, p. 330).* For

example, on average the Company's coal fleet is 53 years old, its nuclear generation system almost 29 years old, its hydroelectric fleet approximately 80 years old, and most of the transmission and distribution system are over 20 years old *(Tr. Vol. 4, p. 333)*. Accordingly, the Company will need to make substantial capital investments going forward, to replace aging and retired infrastructure, and to invest in new, more efficient technologies.

Company witness Jamil testified regarding the Company's nuclear capital additions since the 1991 rate case. Mr. Jamil testified that on September 30, 2008, Duke Energy Carolinas purchased 71.96% of Saluda River Electric Cooperative, Inc.'s ("Saluda River") 9.375% ownership interest in the Catawba Nuclear Station, providing the Company with approximately 7% additional ownership, for approximately $150 million. *(Tr. Vol. 4, p. 516)*.

Mr. Jamil testified further that in 2007 and 2008 Duke Energy Carolinas invested more than $330 million in order to improve the performance of its nuclear facilities and to address refurbishments necessary for license renewals by the Nuclear Regulatory Commission ("NRC") for the Company's Oconee, McGuire and Catawba Nuclear Stations. He demonstrated that the nuclear fleet provides the Company's customers with a reliable, cost-effective and emission-free base load source of electricity, and that renewal of these licenses will allow customers to continue to receive these benefits for at least another 20 years. *(Tr. Vol. 4, p. 518-519)*. Witness Jamil stated that the Company's plans include approximately $1 billion in capital spending for nuclear operations over the next three years. According to Mr. Jamil, major capital projects for the next three years include work related to safety, reliability, refurbishment of aging equipment, replacement or upgrades of obsolete equipment and upgrades and additions to plant systems based on changing regulations and standards. *(Tr. Vol. 4, p. 519-520)*.

Witness Jamil also testified regarding the Company's fossil-hydro capital additions since the 1991 rate case, the most significant of which is the flue gas desulfurization equipment at the Allen Steam Station ("Allen scrubbers"). The direct capital cost associated with the Allen scrubbers is projected to be $502.8 million. In December 2008 the Company added selective catalytic reduction ("SCR") equipment at Marshall Unit 3 in support of various nitrogen oxide ("NO_X") control requirements. The direct capital cost associated with the Marshall Unit 3 SCR equipment through June 30, 2009 is $105 million, and the Company expects to spend an additional $1.5 million on project close-out activities. *(Tr. Vol. 4, p. 520-522).*

Witness Jamil testified the Company has completed a number of environmental projects as well as projects to improve the reliability of the Company's fossil-hydro fleet since 2007. Mr. Jamil noted that although the Company has delayed some capital spending in light of the financial crisis, Duke Energy Carolinas plans to invest approximately $1 billion in its fossil-hydro plants during the period 2009-2011 in order to meet environmental compliance requirements and to continue to provide reliable service to customers. *(Tr. Vol. 4, p. 522-523).*

Witness Turner testified regarding investments Duke Energy Carolinas has made during the test period in its South Carolina electric delivery system. At the end of 1990, the Company's original cost for its distribution and transmission plant in service was $4.3 billion. By the end of 2008, this plant in service had increased to $10.4 billion. According to Mr. Turner, the Company made these investments to add capacity to meet the demands of new and existing customers as well as to improve the reliability and integrity of the system. From January 1, 1991, through December 31, 2008, Duke Energy Carolinas added 391 new substations; added 31,000 miles of distribution lines; added or upgraded 272 circuit miles of transmission lines; installed 665,900 poles and added 926,000 new customers in its service territory. *(Tr. Vol. 4, p. 350).* Witness

Turner testified further that the Company has invested in reliability programs to prevent outages, minimize interruptions and extend the life of its equipment. From January 1, 2009 through September 30, 2009, Duke Energy Carolinas expects to invest an additional $170.9 million in reliability and capacity projects to address the demands of existing customers. *(Tr. Vol. 4, p. 350-351).* He explained that these investments are necessary to maintain the reliability and integrity of the system as equipment ages and growth in specific geographic areas necessitates changes in system configuration.

In addition, Mr. Turner testified that given the Company's obligation to retire existing units and the expiration of purchased power resources, Duke Energy Carolinas must make investments over the next three to five years to ensure adequate resources to meet customer demand. He explained that people and businesses continue to move to the Carolinas, and the Company continues to expect long-term growth in demand despite the current recession. Growth is expected to accelerate when the economy rebounds, and resource needs are expected to increase significantly over the next twenty years. The 2008 Duke Energy Carolinas Annual Plan has identified approximately 2,690 MW of additional resources that are needed by 2012. By 2028, that number grows to 8,800 MW. *(Tr. Vol. 4, p. 340-341).*

According to witness Turner, these resource needs reflect the Company's commitment to retire 445 MW of older coal units by 2012 and an additional retirement of 600 MW of older coal units by 2018. Cliffside Unit 6 and the Buck combined cycle unit, which are expected to be operational by the summer of 2012, will fulfill 1,445 MW of this need. The Company continues to evaluate the timing of the Dan River Combined Cycle project and continues to pursue the development of a new nuclear plant, Lee Nuclear Station. *(Tr. Vol 4, p. 341).*

According to Company witness De May, Duke Energy Carolinas faces substantial capital

needs over the next several years in order to satisfy environmental and other regulatory requirements, refurbish, replace and upgrade aging infrastructure, construct or acquire needed generation resources, and invest greater amounts in energy efficiency. He testified that the Company's capital requirements are projected to be approximately $8.6 billion during the period 2009-2011. This amount consists principally of $8.0 billion in projected capital expenditures and approximately $700 million in debt retirements. *(Tr. Vol. 4, p. 487).* The capital expenditure budget for the current three year period exceeds by approximately $2.0 billion the level spent by the Company in the prior three year period ending with the test period. Mr. De May clarified that the higher level of capital expenditures reflects new generation projects and environmental expenditures that the Company must incur to continue to provide cost-effective, safe, environmentally compliant, and reliable service to its customers, as discussed by witnesses Turner and Jamil. *(Tr. Vol. 4, p. 488).*

According to Company witness Jamil, Duke Energy Carolinas is facing increased operation and maintenance ("O&M") expenses at the same time it is experiencing these substantial capital needs. Witness Jamil explained that nuclear power plant operations are very labor intensive; therefore, a significant portion of O&M costs for nuclear facilities are related to internal and contracted labor. O&M costs will increase approximately $17 million annually as a result of the Company's increased ownership interest in the Catawba Nuclear Station,, and the Company expects to experience continued upward pressure on these ongoing labor costs. In addition, Duke Energy Carolinas expects labor costs to increase approximately $7 million annually due to workforce increases necessary to comply with changes in NRC regulations. *(Tr. Vol. 4, p. 529).* Duke Energy Carolinas also has spent approximately $1 million annually on pipeline program expenses for development of its future engineering and skilled nuclear

workforce. Additional programs are being considered for development of nuclear operators and maintenance technicians due to the demand for skills and age demographics. *(Tr. Vol. 4, p. 529).* Witness Jamil also explained the NRC fees that nuclear owners and operators pay annually will increase in 2009. The increased NRC fees, along with increases in required Institute of Nuclear Power Operations and Nuclear Energy Institute fees, will cost the Company in excess of $5 million annually. *(Tr. Vol. 4, p. 530).*

Mr. Jamil testified that the Company's generation operations continue to face upward pressure on O&M costs, including escalation of labor costs. In addition, the costs to perform maintenance work necessary to address reliability and regulatory concerns are increasing due to rising costs for materials and supplies. *(Tr. Vol. 4, p. 532).*

Witness Jamil noted that Duke Energy Carolinas will incur additional O&M costs over the next three years in order to operate and maintain the environmental control equipment and new generation resources with regard to the Company's fossil and hydro facilities. He testified that the Company has seen rapid and substantial increases in labor, material and contract services required for the operation and maintenance of new and existing facilities over the last several years. Although the recent economic downturn has moderated these increases, Mr. Jamil stated that the Company will continue to be challenged by high costs for these products and services driven by market demand, limited availability of commodities and skilled technical and craft resources, in addition to inflationary pressures.

Witness Turner described ways the Company has worked to control its O&M costs, including temporarily freezing the salaries of a majority of its exempt employees and establishing a goal to reduce O&M expenses across the Duke Energy enterprise by $100 million. *(Tr. Vol. 4, p. 335-336).* According to Mr. Turner, Duke Energy Carolinas faces significant

challenges in operating and maintaining its transmission and distribution facilities despite these and other measures because infrastructure is aging, customers have greater reliability needs, and the reduction in energy sales and new customer additions since the economic downturn results in lower revenues to offset these costs. *(Tr. Vol. 4, p. 359).*

Witness Turner testified that since its last rate case, Duke Energy Carolinas has made substantial capital investments in generation, environmental compliance, transmission, and distribution assets that are being used to provide electric utility service to its customers. As a consequence, Mr. Turner stated that Duke Energy Carolinas' current rates are not providing sufficient revenues for the Company to meet its increasing O&M expenses and also provide its investors with reasonable returns on their investments of needed capital. *(Tr. Vol. 4, p. 328).*

The Settlement Provisions

Witness Turner testified that the Settlement Agreement filed on November 24, 2009 is the product of extensive negotiations between the Company and the Settling Parties. *(Tr. Vol. 4, p. 399).* Witness Turner stated that the Settling Parties believe the Settlement Agreement represents a just and reasonable resolution of the issues in this case. Additionally, the Settling Parties believe various provisions of the Settlement are interrelated, and it is important that the Settlement Agreement be accepted in its entirety. *(Tr. Vol. 4, p. 400).* The Settlement Agreement provides that it is only binding upon the Settling Parties if the entire agreement is approved by the Commission.

Duke Energy Carolinas' witness Shrum testified that under the Settlement Agreement, the Company will adjust its South Carolina retail base rates and tariffs to produce annual revenues of $74,125,000 from its South Carolina retail electric operations. The Settling Parties

agree that these revenues will provide Duke Energy Carolinas the opportunity to earn an overall rate of return of 10.7% on a South Carolina retail jurisdictional rate base of $3,189,295,000, with a long-term debt cost of 5.82% and a rate of return of 11% on the common equity component of a capital structure based on 47% long term debt and 53% member's equity. *(Tr. Vol. 5, p. 887).*

Ms. Shrum explained that under the Settlement Agreement, the total proposed revenue increase is subject to several riders. These riders are: (1) a decrement rider to return funds to customers for the over-collection balance in the deferral account for DSM programs pursuant to Order No. 91-1022, calculated to return the balance to customers over approximately three years; (2) an increment Rider EE effective February 1, 2010, to compensate for the modified save-a-watt program to be updated annually; (3) an increment rider for coal inventory to recover the additional costs through April 30, 2011, of coal inventories exceeding a 40-day supply; (4) an increment rider for pension expense to recover the actual amount of pension expense incurred for 2010 through 2012 to be updated annually; and (5) a decrement rider to flow $13 million annually of the nuclear insurance reserve to customers for two years. *(Tr. Vol. 5, p. 887-888).*

Settlement Agreement Attachment B sets forth the proposed revenue increase by customer class as well as the resulting rates of return.

Company witness Bailey provided testimony supporting the customer rate impacts that are projected to occur as a result of the Settlement and the rate design issues agreed to by the Duke Energy Carolinas, SCEUC and ORS. Mr. Bailey explained that the Company considered the existing rates of return among the classes, the significant impact the economic recession has had on the Company's industrial sales, and the desire to reduce over time the interclass subsidies that exist in current rates. In light of these factors, the Settlement reduces the subsidy level

provided to the residential class and provides some relief to the Company's industrial customers relative to the overall increase. *(Tr. Vol. 5, p.1008-1009).*

Mr. Bailey testified that the Settlement largely adopts the rate design proposals discussed in his direct testimony with the following deviations: (1) Rate MP will be closed and the availability modified to permit only new plants or locations for customers already served under this rate to be eligible for service; (2) no changes will be made to the distribution charges of Rate HP-X; and (3) the Third Block of Rate I will not be modified. *(Tr. Vol. 5, p. 1010).*

According to Ms. Shrum, the revenue requirement in the Settlement includes a pro forma adjustment to establish a storm reserve to be funded at an approximate level of $5 million per year to a maximum fund level of $50 million. *(Tr. Vol. 5, p. 890).* Ms. Shrum stated that under the Settlement, the terminating DSM deferral account balance rider, as adjusted for the Vintage Year 0 revenue requirement, will be implemented over approximately a three-year period. *(Tr. Vol. 5, p. 888).*

SCEUC witness Cochrane provided testimony supporting the Settlement and stated SCEUC believes it is in the public interest. *(Tr. Vol. 5, p. 918).* He stated that SCEUC understands the need for electric utilities to remain healthy; however, he expressed concern for the manufacturing sector which needs fair rates requiring them to pay only the cost to serve them. Mr. Cochrane further testified that manufacturers are struggling to survive and that over the past ten years approximately 130,000 South Carolinians have lost their manufacturing jobs. In the increasingly competitive world in which manufacturers operate, South Carolina manufacturers need fair rates requiring them to pay only the cost to serve them. He stated that the Settlement provides a rate reprieve at a critical time in the current economic recession and will promote job retention and economic development. *(Tr. Vol. 5, p. 919).*

Mr. Cochrane testified that the proposed rate design attempts to address, but does not totally eliminate, the long-standing subsidy from industrial consumers to residential consumers. Manufacturers recognize the need to move at a deliberate pace in eliminating the subsidy to avoid the possibility of rate shock to residential customers. *(Tr. Vol. 5, p. 922).*

ORS witnesses Scott and James indicated that ORS believes the settlement agreement is in the public interest because it balances the concerns of the using and consuming public and the need for economic development and job attraction and retention in South Carolina with the preservation of the financial integrity of Duke Energy Carolinas. *(Tr. Vol. 5, p. 1105 & p. 1171).* The proposed accounting and pro forma adjustments shown on ORS Scott Exhibits SGS-1 and SGS-2 are appended to the Settlement Agreement as Attachment A.

In regard to the accounting adjustments we note that the South Carolina Supreme Court has concluded that adjustments to test year should be made for any known and measureable out-of-period changes in expenses, revenues and investments that would materially alter the rate base. "The object of the test year is to reflect typical conditions. Where an unusual situation exists which shows that the test year figures are atypical the [Commission] should adjust the test year data. Any other standard would negate the aspect of finality created by a test year time limitation." *Parker v. S.C. Public Service Comm'n*, 280 S.C. 310, 312, 313 S.E.2d 290, 292 (1984).

The Commission finds and concludes that the Settlement Agreement appropriately balances the Company's need for rate relief with the impact of such rate relief on customers. The Commission is cognizant of the fact that the nation is still in the midst of a recession and that a rate increase will be difficult for customers to absorb. At the same time, the Company has made and continues to make investments in order to comply with regulatory requirements and

provide reliable electric utility service to its customers, and the Company's rates need to be adjusted to reflect these investments. The Commission agrees that the Settlement Agreement represents a just and reasonable resolution of the issues in this proceeding and therefore is in the public interest.

Substantial evidence in the record supports the provisions of the Settlement Agreement. Accordingly, the Commission is justified in adopting the Settlement Agreement through the exercise of its own independent judgment, and finding and concluding through such independent judgment that the Settlement Agreement is just and reasonable to all parties in light of all the evidence presented. The Commission hereby adopts the Amended Settlement Agreement in its entirety, and sets forth its conclusions as to the individual provisions of the Settlement Agreement more fully below.

(a) Return on Equity

EVIDENCE FOR FINDING AND CONCLUSION NO. 10

The Settlement Agreement provides for base rates to generate a revenue increase of $74,125,000 from South Carolina retail electric operations. The Settling Parties agreed that the rates calculated to generate a $74,125,000 revenue increase would be calculated on an ROE of 10.7% and that the Company be allowed an ROE of 11% in recognition of the Company's base load plans and its current cost of equity.

(1) Capital Structure

Duke Energy Carolinas witness Shrum testified that the Settlement Agreement provides the Company with the opportunity to earn an overall rate of return of 10.7% on a South Carolina retail jurisdictional rate base of $3,189,295,000 with a long-term debt cost of 5.82% and an

allowed rate of return of 11.0% on the common equity component of a capital structure based on 47% long term debt and 53% member's equity. *(Tr. Vol. 5, p. 887).*

According to the Company's Quarterly Financial Report for the Twelve Months ending June 30, 2009, Duke Energy Carolinas' capital structure was approximately 45% long-term debt and 55% equity. According to Company Witness De May, Duke Energy Carolinas has consistently maintained an average equity ratio of 53%. As of the date of its Application, Duke Energy Carolinas' capital structure was approximately 47.0% debt and 53.0% equity. *(Tr. Vol. 4, p. 495-496).*

Company witness De May testified that capital structure is an important component of credit quality. He explained that equity investors provide the foundation of a company's capitalization by providing significant amounts of capital, for which an appropriate economic return is required. Returns to equity investors are realized only after all operating expenses and fixed payment obligations of the business have been paid. According to Mr. De May, because these investors are the last to receive surplus earnings and cash flows, their capital is most at risk if the Company suffers a downturn in business or general financial conditions. This dynamic of equity investors receiving "residual" earnings and cash flows provides debt investors a measure of protection. Therefore, the greater the equity component of capitalization, the safer the returns are to debt investors, which translates into higher credit quality. *(Tr. Vol. 4 , p. 475).*

Mr. De May testified that Duke Energy Carolinas' equity component enables it to maintain its current credit ratings and financial strength and flexibility. Further, Duke Energy Carolinas is in a period of significant capital investment, and the magnitude of its capital needs dictates the need for a strong equity component of the Company's capital structure in order to assure access to capital funding at reasonable terms. *(Tr. Vol. 4, p. 476).* Lack of access to capital

can force interruption of capital projects to the long-term detriment of customers. Strong investment-grade credit ratings provide Duke Energy Carolinas with greater assurance of continued access to the capital markets on favorable terms during periods of extreme volatility. *(Tr. Vol. 4, p. 484).*

Duke Energy Carolinas' outstanding debt is rated by Standard & Poor's ("S&P") and Moody's Investors Service ("Moody's"). Obligations carrying a credit rating in the "A" category are considered strong, investment-grade securities subject to low credit risk for the investor. S&P currently rates Duke Energy Carolinas' secured debt at "A" and its unsecured debt at "A-." Moody's currently rates Duke Energy Carolinas' secured debt at "A2" and its unsecured debt at "A3." *(Tr. Vol. 4, p. 478-479).* "A" rated debt is presumed to be somewhat susceptible to changes in circumstances and economic conditions; however, the debt issuer's capacity to meet its financial commitments is considered strong.[4]

S&P's current assessment of Duke Energy Carolinas' business risk as "Excellent" and its financial risk as "Significant" corresponds to an expected rating of A-, which is the credit rating Duke Energy Carolinas currently maintains at S&P. According to S&P, the expected Debt/Capital ratio for a company with "Significant" financial risk is 45-50%. Therefore, the inverse, or common equity ratio, would be 50-55%. Witness De May testified that Moody's indicates that companies in the "A" rated category should exhibit Debt/Capitalization ratios in the 35-45% range. Therefore, the inverse, or common equity ratio, would be 55-65%. *(Tr. Vol. 4, p. 498).* The capital structure resulting from the Settlement is consistent with what S&P and

[4] For S&P, an "A+" credit rating is at the higher end of the "A" credit rating category and an "A-" is at the lower end of the category. Moody's credit rating assignments use the numbers "1", "2", and "3" to modify its ratings, with the numbers "1" and "3" analogous to a "+" and "-", respectively.

Moody's indicate is appropriate for a company with credit ratings such as Duke Energy Carolinas currently maintains.

The capital structure of approximately 47% debt and 53% common equity is appropriate for the Company in this proceeding. The debt/equity ratio is consistent with the average the Company has maintained for the last decade. The Commission recognizes that, as discussed by witness De May, a strong equity component is a factor in determining the Company's credit rating. The Commission also recognizes the Company's need to raise capital from the testimony of witnesses Turner and Jamil. Accordingly, the Commission finds and concludes that the capital structure of 47% debt and 53% common equity is just and reasonable to all parties in light of all the evidence presented.

(2) Return on Equity

In setting rates, the Commission must determine a fair rate of return that the utility should be allowed the opportunity to earn after recovery of the expenses of utility operations. The legal standards applicable to this determination are set forth in *Federal Power Comm'n v Hope Natural Gas Co.,* 320 U.S. 591, 602-603 (1944) and *Bluefield Water Works and Improvement Co. v. Public Service Comm'n of West Virginia,* 262 U.S. 679, 692-93 (1923). These standards were adopted by the South Carolina Supreme Court in *Southern Bell Telephone & Telegraph Co. v. S.C. Public Service Comm'n*, 270 S.C. 590, 595-96, 244 S.E.2d 278, 281 (1978).

> What annual rate will constitute just compensation depends upon many circumstances, and must be determined by the exercise of a fair and enlightened judgment, having regard to all relevant facts. A public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties; but it has no constitutional right

> to profits such as are realized or anticipated in highly profitable enterprises or speculative ventures. The return should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate, under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties.

Southern Bell Telephone, 270 S.C. at 595-96, 244 S.E.2d at 281 (quoting *Bluefield*, 262 U.S. at 692-93). These cases also establish that the process of determining rates of return requires the exercise of informed judgment by the Commission. As the South Carolina Supreme Court has held:

> Its ratemaking function, moreover, involves the making of "pragmatic adjustments". . . . Under the statutory standard of "just and reasonable" it is the result reached not the method employed which is controlling. . . . The ratemaking process under the Act, i. e., the fixing of "just and reasonable" rates, involves the balancing of the investor and the consumer interests. Thus we stated in the Natural Gas Pipeline Co. case that "regulation does not insure that the business shall produce net revenues." . . . But such considerations aside, the investor interest has a legitimate concern with the financial integrity of the company whose rates are being regulated. From the investor or company point of view it is important that there be enough revenue not only for operating expenses but also for the capital costs of the business. These include service on debt and dividends on the stock. . . . By that standard the return to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks. That return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital.

Southern Bell Telephone, 270 S.C. at 596-97, 244 S.E. 2d at 281. These principles have been employed by the Commission and the South Carolina Courts consistently.

The Company requested approval of a rate of return on common equity ("ROE") of 12.3% and for its rates to be set using an ROE of 11.5%. The Settlement Agreement provides for an ROE of 11% with rates established based on a 10.7% ROE.

Company witness Vander Weide testified in support of the Company's original request as stated in the Application. The methods for estimating the cost of equity for Duke Energy

Carolinas employed by Dr. Vander Weide included the Discounted Cash Flow ("DCF"), the ex ante risk premium, the ex post risk premium, and the capital asset pricing model ("CAP-M"). Based upon his application of these models to his comparable companies, Dr. Vander Weide testified that 11.1% is the simple average of his results from each method. *(Tr. Vol. 5, p. 656-658).*

Witness Vander Weide's electric company group had an average capital structure containing 37.54% debt, 0.72% preferred stock, and 61.74% common equity. Duke Energy Carolinas' capital structure contains 47% long-term debt and 53% common equity. *(Tr. Vol. 5, p. 659).* Dr. Vander Weide explained that he adjusted the 11.1% average cost of equity for his comparable groups by recognizing that to attract capital, Duke Energy Carolinas must have the same weighted cost of capital as his comparable group. Dr. Vander Weide testified that his analysis indicates that Duke Energy Carolinas would require a fair rate of return on equity equal to 12.3% in order to have the same weighted average cost of capital as his comparable companies, and that the Company's required ROE is therefore 12.3%. *(Tr. Vol. 5, p. 659).* Prior to entering into the Settlement Agreement, the Company requested that the Commission approve Dr. Vander Weide's recommendation of a 12.3% ROE, but that the Company's rates be set using an 11.5% ROE in order to mitigate the impact of rate increases upon Duke Energy Carolinas' customers during this tough economic time. *(Tr. Vol. 4, p. 345).* ORS witness Dr. Carlisle provided testimony regarding the Company's cost of equity. He used the CAP-M, the Comparable Earnings Method ("CEM"), and the DCF method to estimate the Company's cost of equity capital. Dr. Carlisle recommended that rates be set an ROE of 10.7% and that an ROE of 11% should apply to any Base Load application that the Company may file due to the higher risk associated with Base Load Construction. *(Tr. Vol. 5, p. 1114).* His analysis resulted in the

following recommended ROEs: DCF was 10.46%, CAP-M was 10.34% and CEM was 11.34%. The mid-point of this range is 10.71%. *(Tr. Vol. 5, p. 1130).*

Witness Turner testified that the Settlement provided for an 11% ROE for the Company with new rates set on a ROE of 10.7%. *(Tr. Vol. 4, p. 400).* Witness Turner indicated that the Company has made and continues to make substantial investments to comply with regulatory requirements and provide high quality electric service to its customers. He testified that Duke Energy Carolinas needs to maintain its financial strength and credit quality to be in a position to finance its capital needs on reasonable terms. He testified that the Settling Parties agreed to 11% as a just and reasonable ROE to be approved for the Company. *(Tr. Vol. 4, p. 401-402).*

SCEUC Witness Kevin O'Donnell used the Discounted Cash Flow model and the Comparable Earnings method in his analysis of an appropriate ROE for Duke Energy Carolinas. Based on the use of these two models, Mr. O'Donnell recommended to the Commission that Duke Energy Carolinas be allowed to earn a ROE of 9.75%. At the hearing, Mr. O'Donnell testified in support of the the Settlement Agreement, which proposes that the Company's electric revenue increase be calculated based on a 10.7% ROE. In considering the appropriate ROE for Duke Energy Carolinas, the Commission reviewed the methodology and conclusions of the witnesses who employed numerical models to calculate the ROE for the Company. The Commission then considered the evidence related to market conditions and investor expectations. Finally, the Commission reviewed the evidence in support of the ROE proposed in the Settlement. The Commission concludes that the Settling Parties' recommended return on common equity of 11% with rates set at 10.7% is just and reasonable and in the public interest.

(3) Rate Base and Revenue Increase

The South Carolina Supreme Court has defined rate base as "the amount of investment on which a regulated public utility is entitled to an opportunity to earn a fair and reasonable return; and represents the total investment in, or the fair value of, the used and useful property which it necessarily devotes to rendering the regulated services." *Hamm v. Public Service Comm'n*, 309 S.C. 282, 286, 422 S.E.2d 110, 112 (1992) (citing *Southern Bell Telephone*, 270 S.C. at 600, 244 S.E.2d at 283). The Commission has the statutory authority after hearing to "ascertain and fix the value of the whole or any part" of Duke Energy Carolinas' rate base, and may "ascertain the value of all new construction, extensions and additions" to such property. S.C. Code Ann. § 58-27-1890 (Supp. 2009).

Duke Energy Carolinas, by its Application and initial direct testimony and exhibits, originally sought an increase of $132.9 million or 9.3% from its South Carolina retail electric operations. The Settlement provides for an increase of $74,125,000 in base rates or 5.2% compared to adjusted test year revenues.

ORS conducted an examination of the Company's Application and supporting books including rate base items. On the basis of this examination, hearing exhibits and testimony, the Commission can determine and find proper balances for the components of the Company's rate base, as well as the propriety of related accounting adjustments. The Commission determines the appropriate rate base, as adjusted, for the test period. This practice enhances the timeliness of the effect of such action and preserves the reliance on historic and verifiable accounts without resorting to speculative or projected figures. The Commission finds it reasonable to continue this regulatory practice and uses a rate base, as adjusted, for the test period ending December 31, 2008, in this proceeding.

ORS filed direct testimony applying several adjustments to conclude that a South Carolina retail electric rate base of $3,189,295,000 was appropriate. *(Tr. Vol. 5, p. 1082-1083).* Settlement Agreement Attachment A shows Duke Energy Carolinas' operating experience, rate base and rate of return for Total Company Per Books and South Carolina retail operations, excluding Greenwood for the test year.[5]

ORS Witness Scott testified that ORS verified total electric – North Carolina and South Carolina – operating revenues of $5,881,779,000, total operating expenses of $4,924,644,000 and net operating income for return of $957,135,000. Total electric – North Carolina and South Carolina – rate base was $11,819,902,000. Witness Scott also explained the allocation to SC Retail Per Books with a net operating income for return of $222,860,000 and total rate base of $2,773,482,000, resulting in a rate of return of 8.25% as reflected in Hearing Exhibit 22. *(Tr. Vol. 5, p. 1082).* ORS Witness Scott explained ORS's proposed Accounting and Pro Forma Adjustments which were subsequently incorporated into the Settlement Agreement Attachment A, Hearing Exhibit 1. *(Tr. Vol. 5, p. 1083-1097).*

Pursuant to the Settlement Agreement, the Setting Parties have agreed upon the following amounts of test year pro forma operating revenues, operating revenue deductions, and original cost rate base (under present rates) to be used as the basis for setting rates in this proceeding: $1,452,461,000 of operating revenues, $1,184,109,000 of operating expenses, and $3,189,295,000 of total rate base for South Carolina excluding Greenwood. *Hearing Exhibit 1, Settlement Agreement, Attachment A.* As Duke Energy Witness Shrum testified, the Settlement will provide the Company with the opportunity to earn an overall rate of return of 10.7% on a

[5] The revenue and cost of service related to the Greenwood County Electric Power Commission are excluded pursuant to S.C. General Assembly Act 1293 of 1966 and *Duke Power Co. v. S.C. Public Service Com'n*, 284 S.C. 81, 326 S.E.2d 395 (1985).

South Carolina retail jurisdiction rate base of $3,189,295,000 with a long-term debt cost of 5.82% and an allowed rate of return of 11.0% on the common equity component of a capital structure based on 47% long term debt and 53% member's equity. *(Tr. Vol. 5, p. 887).*

Based on its conclusions as set forth in this Order, the Commission has reviewed the Settlement Agreement's provisions for an annual non-fuel revenue increase of $74,125,000 and finds and concludes that this increase in the level of base rates to be paid by Duke Energy Carolinas South Carolina retail customers, resulting in an overall rate of return of 8.41% on S.C. jurisdiction rate base and an ROE of 10.7% is just and reasonable to all parties in light of the substantial evidence in the record.

(b) Subsequent Rate Increase Requests

EVIDENCE FOR FINDING AND CONCLUSION NO. 11

The Settlement provides that Duke Energy Carolinas shall not seek an increase in its non-fuel base rates and charges prior to June 2011, and that no increase in non-fuel base rates shall be billed to its customers until the Company's first billing cycle in 2012. The Commission agrees that this provision serves to mitigate the effect of the requested rate increase during this difficult economic time. This provision has not been contested by any party to this proceeding. The Commission finds and concludes that although the Commission does not possess the authority to restrain a public utility from seeking rate relief authorized under South Carolina law, this provision of the Settlement Agreement is just and reasonable to all parties and is in the public interest.

(c) **Riders and Accounting Adjustments**

EVIDENCE FOR FINDING AND CONCLUSION NO. 12

Return of DSM Balance

Order No. 91-1022 in Docket No. 91-216-E approved a deferred accounting process for energy efficiency and demand-side management programs. The Commission finds that the provision of the Settlement Agreement establishing a rider to flow back the over-collection of funds to Duke Energy Carolinas' customers from the DSM balance is reasonable in light of the evidence presented in this proceeding.

Duke Energy Carolinas initially proposed implementing a terminating rider for approximately five years to return the DSM balance to customers. ORS recommended that the funds be returned over a three-year period and returned to the customer classes from whom the monies were collected. *(Tr. Vol. 5, p. 1164).* The Settlement provides for Duke Energy Carolinas to accelerate the over-collection to approximately three years. *(Tr. Vol. 5, p. 888).* Witness Turner testified that the accelerated return of the over-collection will mitigate the rate impact to customers but will not cause a severe adverse impact on the Company because these amounts have been held by the Company on behalf of its customers. *(Tr. Vol. 4, p. 403).* The Commission concludes that this provision of the Settlement Agreement is just and reasonable in light of the evidence presented.

EVIDENCE FOR FINDING AND CONCLUSION NO. 13

Nuclear Insurance Credit

The Commission finds the Settlement Agreement's provision implementing a decrement rider to flow to the Company's South Carolina customers a portion of monies accumulated in the

nuclear insurance reserves account is just and reasonable based upon the evidence of record in this proceeding.

ORS Witness James, adopting the testimony of ORS witness Watts, explained that the Nuclear Electric Insurance Limited ("NEIL") insurance program accumulates reserves to spread the possible cost of a nuclear incident over the lives of nuclear plants. Since September 15, 2009, NEIL's reserves have a surplus of approximately $3.2 billion enabling NEIL to pay dividends to Duke Energy Carolinas. The Company has been able to offset the nuclear insurance premiums and accumulate reserves with the dividends. Because of the extended life of the nuclear plants, the Company expects NEIL to continue paying dividends. ORS recommended that the Company return $26,000,000 from the nuclear insurance reserves to South Carolina retail customers over a two year period through a rate decrement. ORS also proposed allocating the funds to customer classes based on the production plant allocator. *(Tr. Vol. 5, p. 1164-1165).*

Company witness Shrum testified that the Settlement Agreement provides a two-year benefit by lowering customers' rates. She further recommended that, because the Company's nuclear operating licenses have been extended and it expects NEIL to continue its dividend payout policy as its financial performance allows, the Commission and ORS should periodically review the balance in the nuclear insurance reserve account and make determinations about the proper ratemaking treatment for this balance in the future. *(Tr. Vol. 5, p. 889).*

The Commission finds that this rider appropriately balances the Company's need for a rate increase with mitigation of the impact of the rate increase on customers during difficult economic circumstances. We conclude that this provision of the Settlement Agreement is just and reasonable in light of the evidence presented.

EVIDENCE FOR FINDING AND CONCLUSION NO. 14

Storm Reserve Fund

The Commission finds that the Settlement Agreement's provision establishing a Storm Reserve Fund was reasonable based on the evidence in the proceeding. The charge per kWh in base rates will be designed to produce approximately $5,000,000 per year based on test year sales and the total is limited to $50,000,000.

Duke Energy Witness Stillman testified that a pro forma adjustment was proposed to normalize the cost of service for storm restoration costs since the level of costs incurred during the test year was among the lowest the Company experienced in the last ten years. *(Tr. Vol. 5, p. 784-785).* ORS Witness James recommended allowing the Company to establish a storm damage reserve fund. ORS believes that the fund could significantly offset the potential financial impacts associated with severe storm events. The Company experienced destructive ice storms in December 2002 and December 2005 collectively costing approximately $130,000,000. *(Tr. Vol. 5, p. 1146).* Duke Energy Witness Shrum's testimony supported the Settlement's provision establishing the storm reserve fund. *(Tr. Vol. 5, p. 890).*

In Order No. 96-15, the Commission approved SCE&G's request to create a storm damage reserve fund. We conclude that this provision of the Settlement Agreement which provides the same treatment for Duke Energy Carolinas is reasonable and prudent in light of the evidence submitted.

EVIDENCE FOR FINDING AND CONCLUSION NO. 15

Coal Inventory Rider

The Commission finds that the Settlement Agreement's provision creating an interim

rider to defray the carrying costs of fuel-stock inventory is reasonable based on the evidence in the proceeding. The rider will automatically expire when coal inventories reach a full-burn 40-day supply on a sustained basis as defined in Section B(4) of the Settlement Agreement or on April 30, 2011, whichever occurs first. The amount collected will be based on estimated monthly coal inventory levels and will be trued-up to reflect actual monthly coal inventory levels.

In her direct testimony, Company witness Shrum included an adjustment to the Company's working capital to reflect the Company's requirement for a level of coal inventory equal to the coal needed for a 40-day full load burn. *(Tr. Vol. 5, p. 862-863).* In her supplemental direct testimony, she made an adjustment to update the coal inventory to the balance as of August 2009 which had increased to approximately 60 days. *(Tr. Vol. 5, p. 871).*

Company witness Shrum explained that the Company purchases most of its coal under one to three-year contracts with staggered terms in order to maintain an adequate supply. According to Ms. Shrum, spot market prices have historically been much higher than the contract prices the Company has negotiated with its coal suppliers. She testified that in order to obtain these low contract prices, the coal vendors require fixed amounts of coal deliveries. As a result, Duke Energy Carolinas must contract for its future anticipated needs. Ms. Shrum explained that anticipated coal generation has not developed because of the economic downturn, causing coal inventories to materially increase. She further testified that although the Company has been taking steps to mitigate the increasing coal inventories when it can economically renegotiate coal contracts to reduce or defer deliveries, where such opportunities are not available it has determined that the more cost-effective approach is to incur the additional cost of carrying a higher inventory. *(Tr. Vol. 5, p. 871-872).*

ORS witness James testified that ORS supported the Company's proposal to adjust

inventory levels to meet its 40-day target, but did not support the fuel stock adjustment proposed in witness Shrum's supplemental direct testimony. ORS recommended the Company be allowed to recover carrying costs of approximately $3,035,000 associated with its coal forecast for February 2010 through April 2011 of approximately 1,364,000 tons of excess coal inventory above the target level. ORS proposed that these costs be recovered through a rider to expire at the end of April 2011 or sooner if inventories return to the 40-day target level. *(Tr. Vol. 5, p. 1147-1149).*

The Commission finds that this increment rider is fair to both customers and the Company, in that it gives the Company some financial flexibility to manage its coal inventory in excess of target levels due to the downturn in the economy, while protecting customers from having to pay for increased coal supply after levels return to normal. We conclude that the coal inventory rider is just and reasonable.

EVIDENCE FOR FINDING AND CONCLUSION NO. 16

Pension Costs Rider

The Commission concludes that the Settlement Agreement's provision removing the adjustment for operating expenses of $3,574,000 in pension costs and the establishment of a rider to collect the difference between the pension expense amount collected in base rates and the actual expense amount is just and reasonable based upon the evidence. The rider will be adjusted annually and is subject to a true-up. Duke Energy Carolinas must provide a quarterly tracking report to ORS regarding Pension Fund obligation and the market value of the assets available to meet that obligation. The Pension Cost Rider shall be evaluated during Duke Energy Carolinas' next general rate case, but, regardless of when Duke Energy Carolinas next files for an

adjustment in its rates and charges, the Pension Cost Rider will expire no later than three (3) years from the date of the this Order.

Company witness Shrum testified that operating expenses were increased to reflect increased pension expense required under Statement of Financial Accounting Standards ("SFAS") No. 87, "*Employers' Accounting for Pensions*," as amended by SFAS No. 158, "*Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans.*" The increased pension expense is a direct result of an unusually large reduction in the fair value of pension assets, which was directly attributable to the recent downturn in the United States economy. The accounting standards require that pension income or expense be determined, in part, based upon a measurement of the fair market value of the Pension Plan's assets at the end of the previous fiscal year (December 31). To assist in meeting the benefit obligations of the Pension Plan, the funds within the Pension Plan are invested in various investment vehicles. As a direct result of this downturn in the U.S. economy, the Pension Plan experienced a significant decline in the fair value of its assets. The lower asset value of the Pension Plan assets and the lower expected rates of return resulted in the increase in pension expense the Company proposed be reflected in the pension costs adjustment. *(Tr. Vol. 5, p. 873-874).*

ORS witness Scott recommended using an increment rider of $3,574,000 instead of including the increase in cost of service. *(Tr. Vol. 5, p.1088).* Duke Energy witnesses Shrum and Turner testified in support of the proposed increment rider. The new Pension Costs Rider will allow recovery for the actual amount of pension expense on an annual basis. *(Tr. Vol. 4, p. 402-403 & Tr. Vol 5, p. 889).*

The Commission agrees and concludes that this rider appropriately balances the Company's need for a rate increase with mitigation of the impact on customers during the difficult economic circumstances.

EVIDENCE FOR FINDING AND CONCLUSION NO. 17

Capacity Purchase

The Commission concludes that the Settlement's provision removing the South Carolina jurisdictional costs associated with the capacity purchase from Columbia Energy, LLC from base rates and amortizing them over a two-year period is reasonable and in the public interest.

ORS's examination of the Company's operating expenses revealed a 520 MW capacity purchase from Columbia Energy, LLC during the test year. The Company entered into a one-year capacity purchase contract to mitigate the effect of the drought during the test year. ORS concurred with Duke Energy Carolina's decision to ensure reliability by securing capacity to mitigate drought impacts, but did not believe it should be incorporated into the test year as an ongoing expense. ORS recommended that the cost be amortized over a two-year period. *(Tr. Vol. 5, p. 1167).* The recommendation was incorporated into the Settlement Agreement.

The Commission agrees with ORS that the decision to purchase capacity was prudent at the time given the severe drought conditions experienced in the Company's service area during 2008. We also agree that this extraordinary expense should not be incorporated as an ongoing expense. Therefore, we conclude that this adjustment and proposed amortization provision is just, reasonable, and in the public interest.

EVIDENCE FOR FINDING AND CONCLUSION NO. 18

GridSouth Adjustment

The Commission concludes that the GridSouth investment was prudently incurred, prudently abandoned, and that Duke Energy Carolinas can recover its investment over a five-year period excluding any return or carrying cost on the investment based on the evidence in this proceeding and the Commission's prior rulings related to GridSouth.

The Company proposed an adjustment to amortize the deferred cost associated with its investments in the GridSouth Project (the "Project"). Duke Energy Carolinas witness Stillman explained that the Company incurred costs to comply with directives issued by FERC that required utilities regulated by FERC to file a plan to join or form a Regional Transmission Organization ("RTO"). Duke Energy Carolinas, Progress Energy Carolinas, Inc. and SCE&G planned to establish GridSouth as an RTO responsible for the functional control of the companies' combined transmission systems. Shifts in FERC policy toward RTOs and matters of state and federal jurisdiction caused the three utilities to suspend the implementation of the Project. FERC allowed the deferral of the Project's costs in its accounting order to the Company issued on January 25, 2001 in FERC Docket No. EL01-13-000. *(Tr. Vol. 5, p. 789).*

ORS witness Scott testified that GridSouth expenses were verified to the Company's books and records. ORS recommended disallowing all carrying charges associated with the investment and allowing charges of $9,436,497 allocated over five years. *(Tr. Vol. 5, p. 1090).* ORS witness James, adopting ORS witness Watts' testimony, also testified about the Commission's previous rulings on the Project and the issue of cost recovery for SCE&G. *(Tr. Vol. 5, p. 1165-1166).* In Order No. 2005-2, the Commission found the GridSouth investment was prudently incurred, prudently abandoned, and allowed a five-year amortization recovery

period excluding any return or carrying cost on the investment. We agree with ORS that Duke Energy Carolinas' investment should receive the same treatment.

The Company incurred these costs specifically in response to regulatory orders and directives. Regulated utilities must respond to and remain in compliance with the directives of their regulators, including the FERC. Therefore, we conclude that the Settlement Agreement's provision allowing Duke Energy Carolinas to recover its South Carolina retail cost of $9,436,497 over five years with $1,887,299 to be included in test year expenses as reasonable, in the public interest, and in keeping with its treatment of the GridSouth investments by SCE&G.

(d) Rate Increase Allocation & Design

EVIDENCE FOR FINDINGS AND CONCLUSIONS NO. 19 & 20

The Commission concludes that the Settlement Agreement's provision allowing an increase in annual revenues of $74,125,000 subject to the riders outlined above is in the public interest, prudent and reasonable in light of all the evidence presented. We also conclude that the proposed rate increases and the respective rates of return by customer class as set forth in Settlement Agreement Attachment B represent an appropriate reduction to interclass rate subsidies and are just and reasonable.

Once a utility's revenue requirement has been determined, a rate structure must be developed that yields the required return. The basic objective of a rate structure is to enable a company to generate its revenue requirement without unduly burdening one class of customer to the benefit of another. Proper rate design results in rates where each customer and each customer class pay as close as practicable the cost of providing service to them.

Company witness Turner testified that the Settlement Agreement reflects a constructive

approach to providing necessary rate relief that will allow the Company to maintain its financial strength and credit quality and continue to provide high quality electric utility service to its customers, while at the same time mitigating the impact of the rate increase on customers. The Settlement Agreement allows for an average net rate increase to customers, including the effects of all riders, of 3.1% effective February 1, 2010. *(Tr. Vol. 4, p 284).*

Company witnesses Bailey and Stillman discussed the Company's processes for developing its rate proposals. Duke Energy Carolinas witness Stillman prepared the cost of service studies that Mr. Bailey used as a major component for the rate design. *(Tr. Vol. 5, p 970).* The purpose of a cost of services study is to allocate the Company's revenues, expenses, and rate base among the regulatory jurisdictions and customer groups based on their service requirements. Once all costs and revenues are assigned, the study identifies the return on investment the Company earned during the test year. These returns then can be used as a guide in designing rates to provide the Company an opportunity to recover its costs and earn its allowed rate of return. *(Tr. Vol. 5, p 774-775).*

Company witnesses Carter and Bailey addressed the disparity in the rates of return among customer classes. Mr. Carter testified that a touchstone of ratemaking is the concept that each customer and customer class should pay as close as is reasonably practicable the costs incurred by the utility to meet their respective energy needs. *(Tr. Vol. 4, p 577).* The 2008 test year overall rate of return for South Carolina was 6.47%. The industrial, general service and time-of-use customers' rates of return were 16.1%, 22.4% and 9% higher than the overall rate of return while the residential customers were 16.3% lower than the overall rate of return indicating that residential customers have been subsidized by the other classes. *(Tr. Vol. 4, p 577-578).* Company witness Bailey testified that the Company's class cost of service study illustrates that a

significant disparity exists across the customer classes. The subsidy extends beyond the range of reasonableness generally defined as class rates of return within 10% of the total Company rate of return. *(Tr. Vol. 5, p. 986, 1008-1009 & Hearing Exhibit 20).* The Commission accepted the 10% range in the Company's last general rate case in Order No. 91-1022.

Company witness Carter testified that residential customers have been subsidized by the other classes for a significant period of time. He testified that the disparity was not only unfair, but it also puts industrial and commercial customers at a competitive disadvantage.

Company witness Bailey described how the rate increase is allocated to the customer classes pursuant to the terms of the Settlement Agreement. The existing rates of return among the classes, the impact of the recession on the Company's industrial sales and the desire to reduce the interclass subsidies over time were considered in the Settlement Agreement. He testified that the Settlement provided that more progress would be made in reducing the subsidy level provided to residential service and provided some relief to the Company's industrial customers relative to the overall increase. The Settling Parties assigned revenue responsibility to the classes that will bring most major customer groups within the band of reasonableness defined as class rates of return within 10% of the total Company rate of return. *(Tr. Vol. 5, p. 1008-1009).* Settlement Agreement Attachment B (Hearing Exhibit 1) contains the proposed rate increases by customer class and the resulting rates of return.

The reduced size of the proposed increase allows greater progress to be made in reducing the subsidy provided to the residential class and provides industrial customers significant relief during difficult economic conditions. The amount of subsidy to the residential class is reduced by approximately 64% *(Tr. Vol. 5, p. 1009-1010).*

SCEUC witnesses Cochrane and O'Donell also provided testimony in support of the

proposed rate design. Mr. Cochrane testified that manufacturers recognize the need to move at a deliberate pace to eliminate the subsidy to avoid the possibility of rate shock to residential customers. He indicated that South Carolina manufacturers need fair electric rates based on equitable rate designs in order to compete with plants in other states and all over the globe. Price increases experienced today could very well lead to more plant closings and layoffs. He testified that the Settlement Agreement's rate design promotes the interests of job retention and economic development. *(Tr. Vol. 5, p. 922-923).*

SCEUC witness O'Donnell noted that when industrial load falls, other rate classes must pick up a higher proportion of the utility's fixed and certain variable costs. As a result, the closing of an industrial facility will not only result in the loss of jobs, but will also result, in the long term, in higher residential and commercial electric rates. He recognized that the rates in the Settlement Agreement are designed to take a meaningful step towards elimination of the subsidy Duke Energy Carolinas' industrial customers have paid on behalf of the Company's residential customers. He pointed out that under the Settlement Agreement industrial customers rates are being held flat prior to the implementation of the various riders that are a part of the settlement. The largest of these riders is the DSM decrement rider, under which the sixty percent of the DSM balance paid by the industrial class will be returned to the industrial class. Thus, the decrease in industrial rates is attributable to the refund to industrial customers of the DSM balance and other decrements. *(Tr. Vol. 5, p. 1069-1071).*

Under South Carolina law, the Commission is vested with the authority to fix just and reasonable utility rates. S.C. Code Ann. §§ 58-3-140, 58-27-810 (1976 & Supp. 2008). Under this statute, the Commission has traditionally adhered to the following principles:

(a) the revenue-requirement or financial-need objective, which takes the form of a

> fair-return standard with respect to private utility companies; (b) the fair-cost-apportionment objective, which invokes the principle that the burden of meeting total revenue requirements must be distributed fairly among the beneficiaries of the service; and (c) the optimum-use or customer-rationing objective, under which the rates are designed to discourage the wasteful use of public utility services while promoting all use that is economically justified in view of the relationships between cost incurred and benefits received.

Bonbright, *Principles of Public Utility Rates* 292 (1961). These criteria have been used by the Commission in previous cases and are again utilized here. (*see, e.g.,* Order No. 2005-2 at 105 and 2003-38 at 76).

Retail rates should produce rates of return among classes that bear a reasonable relationship to the Company's overall rate of return and should include movement toward equal rates of return among classes. The Commission is mindful of the implications of a rate increase on any class of customers and also of the financial requirements of the utilities it regulates.

We approve the Settlement Agreement's rate design provisions because it moves toward our goal of having retail rates among the classes bear a reasonable relationship to the Company's overall rate of return. We conclude that these findings are in the public interest, reasonable and prudent, and supported by substantial evidence contained in the record.

EVIDENCE FOR FINDINGS AND CONCLUSIONS NO. 21

The Commission concludes that the Settlement Agreement's provisions for certain changes in Duke Energy Carolinas' rate design and service regulations are just and reasonable based on the testimony and evidence in this proceeding.

The Settlement Agreement adopted the proposed rate design modifications of Company witness Bailey with the exception of the following items listed below. These agreed-upon modifications to his proposal include the following:

a. Rate MP will be closed and the availability will be modified to permit new plants or locations for customers already served under this rate to be eligible for service.
b. No changes will be made to distribution charges of Rate HP-X (Renamed Rate HP).
c. The Third Block of Rate I will not be modified at this time.
d. The incremental demand charge of Rate HP-X (renamed Rate HP in this case) will not be increased.

(Tr. Vol. 5, p. 1010).

The Company originally proposed closing Schedule MP, Multiple Premises Service, to new customers. Company witness Bailey testified that the rate was originally approved as a pilot program and was intended to provide a means to learn about aggregation in anticipation of retail competition. *(Tr. Vol. 5, p. 978).* SCEUC did not agree that it should be closed and asserted that the MP rate allowed some of South Carolina's largest industrial employers to save funds by actively managing loads. *(Tr. Vol. 5, p. 1054-1055).* As part of the Settlement Agreement, the Settling Parties agreed that customers being served under Schedule MP will be eligible for service for their new plants or locations under this rate.

Company witness Bailey testified about several changes originally proposed to Rate HP-X. First, the Company proposed modifying the distribution charge to more appropriately reflect the cost to serve incremental load since the cost of service study indicated that the rate was subsidized. The Company also proposed adjusting the Incremental Demand Charge and changing the name to HP to eliminate the connotation that it was still an experimental rate. *(Tr. Vol. 5, p. 978).* SCEUC objected to the proposed changes in the rates as contrary to efforts to promote demand-side management and energy efficiency. *(Tr. Vol. 5, p. 1056).* As part of the Settlement Agreement, no changes will be made to the distribution charges or the incremental demand charge on Rate HP-X.

Company witness Bailey described the proposed change in rate to the Third Block of

Rate I. He testified that the pricing for this block is the least expensive for the rate and out of character with the overall design. The Third Block generally applies to larger customers whose demand exceeds 720kW. *(Tr. Vol. 5, p. 977).* SCEUC objected to the proposed change in the rate. SCEUC Witness O'Donnell testified that by denying this rate to industrial customers, the Company would be putting a further hardship on industrial customers at a time when they are struggling to keep their doors open. *(Tr. Vol. 5, p. 1053).* The Settlement Agreement states no changes will be made to the Third Block of Rate I, which applies to larger customers.

The Commission finds and concludes that the rate design and service regulations proposed by the Company in its Application and in its testimony and exhibits filed in this proceeding, as modified by the changes agreed upon in the Settlement Agreement, are just and reasonable to all parties in light of all the evidence presented.

(e) Modified Save-a-watt Proposal

EVIDENCE FOR FINDINGS AND CONCLUSIONS NO. 22 through 25

The Commission concludes that approval of the modified save-a-watt proposal is in the public interest, and that the revisions agreed to by the Settling Parties are reasonable and prudent based upon the substantial evidence in the record. The evidence in support of this finding is based upon the testimony and exhibits of Duke Energy Carolinas witnesses Smith, Stevie, and McManeus, the Environmental Intervenors' witness Wilson and ORS witness Cooney.

Company witness Smith described the proposed modified save-a-watt compensation mechanism and discussed the stakeholder engagement process to develop new program ideas and to review measurement and verification results. Duke Energy Carolinas seeks approval of an energy efficiency and demand-side management Rider to compensate the Company for

delivering verified energy and capacity savings. The Company would not be compensated under the Rider for expenses associated with save-a-watt programs that do not generate verified savings. Duke Energy Carolinas would be compensated on a percentage of avoided costs. The Company will pay for marketing, administration, program incentives, and measurement and verification costs from this revenue stream. *(Tr. Vol. 6, p. 1189-1191).* Company witness Smith also described how the modified save-a-watt plan provides greater benefits to consumers than the original plan by offering more energy savings, greater transparency, lower percentage of avoided cost, tiered earnings caps based on performance targets, and greater stakeholder involvement. *(Tr. Vol. 6, p. 1193).*

The Environmental Intervenors support the modified save-a-watt approach and recommend that the Commission approve it. Environmental Intervenors witness Wilson believes that the modified save-a-watt proposal fairly balances the interests of the Company and its customers while promoting aggressive reductions in demand and energy use. *(Tr. Vol. 6, p. 1315).* The modified save-a-watt approach will nearly double the short-term energy savings potential of the programs and limits the Company's earnings to protect customers' interest in fair rates. The modified proposal accomplishes this through enhanced savings targets, an earnings cap, lost revenue recovery for a limited period, and a "tiered" performance incentive structure. Taken together, these modifications to the original plan provide the Company with a strong incentive to achieve energy savings, while ensuring that customers benefit financially by taking advantage of low-cost energy efficiency resources rather than paying for higher cost power plants. *(Tr. Vol. 6, p. 1317).*

ORS witness Cooney recommended to ORS and the Commission that the Company fund the selection and hiring of an independent consultant to provide detailed oversight of EM&V

services, avoided cost savings calculations, and other aspects of the save-a-watt program implementation. *(Tr. Vol. 6, p. 1351).* The Settling Parties agreed that ORS would hire an independent third party consultant to provide independent oversight of the save-a-watt mechanism. The independent consultant's oversight will include, but not be limited to, EM&V and avoided cost savings calculations. The Settling Parties also agreed that the EM&V activity should include verification of calculations through the determination of final avoided costs, rather than just verification of achieved energy and capacity savings. Additionally, Duke Energy Carolinas has agreed to provide the actual hourly avoided costs calculated from DSMore© in a manner that can be reviewed and verified by an independent third party in advance of implementation of the Rider EE compensation mechanism. *(Tr. Vol. 6, p. 1300-1301).* We agree with Company witness McManeus who testified that this modification is in the public interest because it provides a benefit of greater transparency of the save-a-watt proposal. *(Tr. Vol. 5, p. 844).*

The Settlement Agreement also affected the Existing DSM programs by stating that all costs associated with Existing DSM Programs will be excluded from the Company's save-a-watt program targets and cost recovery.[6] Witness McManeus discussed Duke Energy Carolinas' recovery of the costs of Existing DSM Programs, which will be based on traditional program cost recovery and will be recovered from all native load customers. *(Tr. Vol. 5, p. 843).* McManeus also testified that the removal of recovery of Existing DSM Program costs from the save-a-watt recovery model and recovery of such costs based on program costs provides

[6] Riders IS and SG have been replaced in South Carolina by the Company's PowerShare program pursuant to the Commission's Order in Docket No. 2009-166-E earlier this year, and existing programs will be cancelled on May 31, 2010. Because the South Carolina Riders IS and SG do not close until mid-2010, the capacity savings associated with those programs from June 1, 2009 through May 31, 2010 are not part of the save-a-watt compensation mechanism. *(Tr. Vol. 6, p. 1219-1220).*

alignment between the compensation to the Company for such programs between South Carolina and North Carolina which is in the public interest. *(Tr. Vol. 5, p. 844).*

The Settlement Agreement also resulted in the avoided energy and capacity costs being fixed until the EM&V true-ups occur. If combined avoided energy and capacity costs increase or decrease by more than 25%, the programs will be re-analyzed to determine whether the portfolio of programs should be modified. The Settlement proposes that if avoided cost rates change by more than 25% any of the Settling Parties may request Commission approval of a revision to the fixed percentages of avoided cost payment levels (currently set at 75% for DSM programs and 55% for energy efficiency programs), the avoided costs per MWh and MW-year, and avoided cost savings target dollars. *(Tr. Vol. 5, p. 842).*

Company witness McManeus also explained the Settlement's modification of Duke Energy Carolinas' original proposed EM&V true-up in year 6. *(Tr. Vol. 5, p. 841).* ORS witness Cooney recommended a mid-term EM&V true-up process that would be reflected in vintage year 3 Rider EE collections. *(Tr. Vol. 6, p. 1355).* Duke Energy Carolinas witness McManeus testified that the Settlement provides for the Company to conduct a mid-term EM&V true-up in addition to the EM&V true-up in year 6. The mid-term EM&V true-up would be included in its Rider EE for Vintage Year 3. This mid-term true-up will incorporate the most recent available EM&V results to update assumptions and to revise planned spending, savings, projected revenue and projected kW and kWh impacts. The mid-term EM&V results will be used in the determination of future Rider EE amounts for billing remaining save-a-watt vintages. The final EM&V true-up in year 6 will incorporate all EM&V studies on net-to-gross results and measure-level savings completed since the mid-term EM&V true-up. *(Tr. Vol. 5, p. 841).* We agree with ORS witness

Cooney that the mid-term EM&V true-up will help in minimizing over or under collection of revenues which is in the public interest. *(Tr. Vol. 6, p.1355).*

The next modification of the save-a-watt proposal related to the opt-out provision for industrial customers. Witness Smith testified about the original proposed opt-out provision. Large commercial and industrial customers whose maximum annual peak load demands exceed 3500 kW per individual account could opt-out. The opt-out for demand-side management programs would be a one-time election by qualifying customers. Customers would be allowed to opt in and out of the energy efficiency programs each year during an annual 60 day enrollment period. *(Tr. Vol. 6, p. 1204).* SCEUC witness O'Donnell proposed that the opt-out threshold of 3500 kW be eliminated and that the certification requirement for exemption be modified. O'Donnell asserted that many industrial customers have already completed their own energy efficiency and demand-side management programs and that South Carolina manufacturers are disadvantaged by the proposed opt out criteria. *(Tr. Vol. 6, p. 1360).* The Settlement Agreement allows all industrial customers to opt out of the demand-side management and/or the energy efficiency components of Rider EE. All other provisions of the Company's original proposal relating to the Rider EE opt-out remain unchanged. *(Tr. Vol. 6, p. 1220).*The Settlement also provides that the forecasted retail sales and the anticipated participant rate in demand-side management and energy efficiency programs will be adjusted to the extent that industrial customers opt out of the energy efficiency plan.

Company witness McManeus explained the impacts of the agreed-upon modifications to the modified save-a-watt targets and cost recovery proposal resulting from the Settlement. The Settlement Agreement provides that revised Rider EE rates for Vintage 1 are as follow:

Residential	0.1736 ¢/kWh
Non-residential –Energy Efficiency	0.0195 ¢/kWh
Non-residential – Demand Side Management	0.0360 ¢/kWh

(Tr. Vol. 5, p. 842-844). The revised Rider EE rates for Vintage 1 are designed to recover the revenue requirement and reflect a net decrease in customer rates as a result of the settlement changes compared to the originally proposed rider. *(Tr. Vol. 5, p. 844).*

Duke Energy Carolinas' modified save-a-watt plan encourages the aggressive pursuit of energy efficiency consistent with the South Carolina Energy Conservation & Efficiency Act of 1992 (the "Act"). S.C. Code Ann. §§58-37-10, *et al.* (Supp. 2009). The Act authorizes the Commission to adopt procedures to encourage electrical utilities to invest in cost-effective energy efficient technologies and energy conservation programs. These procedures must provide incentives and cost recovery for energy suppliers who invest in energy supply and end-use technologies that are cost effective, environmentally acceptable, and reduce energy consumption or demand. These procedures must allow energy suppliers to recover costs and to obtain a reasonable rate of return on their investment in qualified demand-side management programs that are at least as financially attractive as construction of new facilities. S.C. Code Ann. § 58-37-20.[7]

[7] S.C. Code Ann. Section 58-37-20 (Supp. 2009) provides that:

> The South Carolina Public Service Commission may adopt procedures that encourage electrical utilities and public utilities providing gas services subject to the jurisdiction of the commission to invest in cost-effective energy efficient technologies and energy conservation programs. If adopted, these procedures must: provide incentives and cost recovery for energy suppliers and distributors who invest in energy supply and end-use technologies that are cost-effective, environmentally acceptable, and reduce energy consumption or demand; allow energy suppliers and distributors to recover costs and obtain a reasonable rate of return on their investment in qualified demand-side management programs sufficient to make these programs at least as financially attractive as construction of new generating facilities; require the Public Service Commission to establish rates and charges that ensure that the net income of an electrical or gas utility regulated by the commission after implementation of specific cost-effective energy conservation measures is at least as high as the net income would have been if the energy conservation measures had not been implemented. For purposes of this section only, the term "demand-side activity" means a program conducted by an electrical utility or public utility

The Act gives the Commission broad authority to allow energy suppliers to recover costs and obtain a reasonable rate of return on their investment. To compensate and encourage the Company to conserve capacity through energy efficiency, we find that the Settlement Agreement's request for approval of Rider EE as part of the modified save-a-watt plan is prudent, reasonable, and in the public interest. The modified save-a-watt plan provides an appropriate incentive because it allows the Company an earnings opportunity similar to investment in generation, yet offers a discount to customers compared to supply side investment. Furthermore, the Company's modified save-a-watt plan has satisfactorily addressed each of the issues raised in the Commission's Order No. 2009-109, Docket No. 2007-358-E. Therefore, we approve the Company's request for approval of the modified save-a-watt approach and conclude that the provision of the Settlement Agreement related to the modified save-a-watt plan is consistent with the law and public policy of South Carolina and in the public interest.

CONCLUSION AND ORDER

After hearing the testimony of the witnesses and based on the Commission's review of the Application, the Settlement, and the testimony and exhibits submitted during the hearing, the Commission adopts as just and reasonable and in the public interest all terms and provisions of the Settlement as a comprehensive compromise resolution of all issues. This includes: (1) the accounting and pro forma adjustments appended to the Settlement Agreement as Attachment A; (2) base rates generating a revenue increase of $74,125,000; (3) rates in this proceeding

providing gas services for the reduction or more efficient use of energy requirements of the utility or its customers including, but not limited to, utility transmission and distribution system efficiency, customer conservation and efficiency, load management, cogeneration and renewable energy technologies.

established on a 10.7% ROE; (4) in recognition of the Company's base load plans and its current cost of equity, allowing the Company an ROE of 11%; (5) the Company's services are adequate and are being provided in accordance with the requirements set out in the Commission's rules and regulations pertaining to the provision of electric service; and (6) the Company's modified save-a-watt proposal incorporating the provisions set forth in the Settlement Agreement. The Commission also specifically adopts as just and reasonable the proposed rate increases set forth in Settlement Agreement.

IT IS THEREFORE ORDERED THAT:

1. The Settlement Agreement entered into by the Settling Parties to this docket is adopted and approved as just and reasonable in its entirety.

2. That Duke Energy Carolinas shall be allowed to increase its rates and charges effective for service rendered as of February 1, 2010 so as to produce an increase in annual revenues from base rates for its South Carolina retail operations of $74,125,000 based upon the adjusted test year level of operations, as set forth in this Order;

3. The calculation of the base rates required to generate a $74,125,000 revenue increase shall be established based on a 10.7% ROE;

4. The ROE of eleven percent (11%) agreed upon in the Settlement is adopted as just and reasonable and in the public interest;

5. That the rate design and service regulations proposed by the Company in its Application and in its testimony and exhibits filed in this proceeding, as modified by the changes agreed upon in the Settlement Agreement, are approved;

6. The accounting adjustments in the Settlement Agreement are adopted as just and reasonable and in the public interest;

7. That Duke Energy Carolinas shall not seek an increase in its non-fuel base rates and charges prior to June 2011, or use a test year earlier than 2010, and that in any case no increase in non-fuel base rates shall or may be billed to its customers until the Company's first billing cycle in 2012.

8. The parties shall abide by all terms of the Settlement Agreement;

9. That the Company shall implement a decrement rider to return the over-collection of funds to customers from the DSM balance apportioned in accordance with the class of customers supplying revenues to the Company during the period of the DSM program over a three-year period or until the DSM balance is exhausted;

10. That the Company shall implement a decrement rider to return to its South Carolina customers $13,000,000 per year for a period of two years constituting a portion of the monies previously credited to the Company's nuclear insurance reserves account;

11. That the Company shall include a charge per kWh in base rates to establish a Storm Reserve Fund. The charge will be designed to produce approximately $5,000,000 per year based on test year sales and the amount in the Storm Reserve Fund shall not exceed a total of $50,000,000.

12. That the Company shall implement an interim rider to defray the carrying costs of coal inventory over target. The rider will automatically expire when coal inventories reach a full-burn 40-day supply on a sustained basis or on April 30, 2011, whichever occurs first. The amount collected is to be based on estimated monthly coal inventory levels and shall be trued-up to reflect actual monthly coal inventory levels.

13. That the Company shall implement an increment rider to collect the difference between the pension expense amount collected in base rates and the actual expense amount. The rider is adjusted annually and subject to a true-up. The Pension Cost Rider will be evaluated during Duke Energy Carolinas' next general rate case and regardless of when Duke Energy Carolinas next files for an adjustment in its rates and charges, the Pension Cost Rider will expire no later than three years from the date of this Order.

14. That Duke Energy Carolinas' modified save-a-watt plan and Rider EE proposed by the Company in its Application and in its testimony and exhibits filed in this proceeding, as modified by the changes agreed upon in the Settlement Agreement, is hereby approved;

15. This Order shall remain in full force and effect until further Order of the Commission.

BY ORDER OF THE COMMISSION:

Elizabeth B. Fleming, Chairman

ATTEST:

John E. Howard, Vice Chairman

BEFORE

THE PUBLIC SERVICE COMMISSION

OF SOUTH CAROLINA

DOCKET NO. 2009-226-E

IN RE:

Application of Duke Energy Carolinas, LLC for Authority to Adjust and Increase Its Electric Rates and Charges	)	**CERTIFICATE OF SERVICE**

This is to certify that I, Chrystal L. Morgan, have this date served one (1) copy of the **PROPOSED ORDER** in the above-referenced matter to the person(s) named below by causing said copy to be deposited in the United States Postal Service, first class postage prepaid and affixed thereto, and addressed as shown below:

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Chrystal L. Morgan

Chrystal L. Morgan

January 8, 2010
Columbia, South Carolina